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APPENDIX

STATUTES AND REGULATIONS INVOLVED

INTERNAL REVENUE CODE OF 1939

22(a): "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service . . . of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. . . .

115(a): "The term dividend . . . means any distribution made by a corporation to its shareholders . . . whether in money or other property. . . .

115(c): "Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock . . . and amounts distributed in partial liquidation of a corporation . . . shall be treated as in part or full payment in exchange for the stock . . . or as a distribution to which section 115(a) applies, or as both, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary. . . .

INCOME TAX REGULATIONS 111, UNDER 1939 CODE

29.22(a)-1: "The fact that a dividend is declared shortly after the sale of corporate stock and the sale price is influenced by the expectation of the payment of a dividend does not make such dividend, when paid, taxable to the vendor as a dividend. The amount advanced by the vendee to the vendor in con-

templation of the next dividend payment is an investment of capital and may not be claimed as a deduction from gross income. * * *"

29.42-2: "Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition. * * *"

29.42-3: "* * * Dividends on corporate stock are subject to tax when unqualifiedly made subject to the demand of the shareholder. * * *"

29.115-5: "Amounts distributed in complete liquidation of a corporation are to be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation are to be treated as in part or full payment, in exchange for the stock so cancelled or redeemed. The gain or loss to a shareholder from a distribution in liquidation is to be determined, as provided in section 111 and section 29.111-1, by comparing the amount of the distribution with the cost or other basis of the stock provided in section 113; but the gain or loss will be recognized only to the extent provided in section 112, and shall be subject to the conditions and limitations provided in section 117. * * *"

INCOME TAX REGULATIONS UNDER 1954 CODE

1.61-9(c): "When stock is sold, and a dividend is both declared and paid after the sale, such dividend is not gross income to the seller. When stock is sold after the declaration of a dividend and after the date as of which the seller becomes entitled to the dividend, the dividend ordinarily is income to the seller. When stock is sold between the time of declaration and the time of payment of the dividend, and the sale takes place at such time that the purchaser becomes entitled to the dividend, the dividend ordinarily is income to him. The fact that the purchaser may have included the amount of the dividend in his purchase price in contemplation of receiving the dividend does not exempt him from tax. Nor can the purchaser deduct the added amount he advanced to the seller in anticipation of the dividend. That added amount is merely part of the purchase price of the stock. * * *"

OPINION OF COURT OF APPEALS

IN THE

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

No. 12762 SEPTEMBER TERM, 1959 JANUARY SESSION, 1960

AVERY BRUNDAGE and ELIZABETH D. BRUNDAGE, *Plaintiffs-Appellants*, v. UNITED STATES OF AMERICA, *Defendant-Appellee*.	Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

February 5, 1960

Before MAJOR, SCHNACKENBERG and CASTLE, *Circuit Judges*.

SCHNACKENBERG, *Circuit Judge*. Avery Brundage and Elizabeth D. Brundage, his wife, plaintiffs, appealed from the district court's order dismissing with prejudice and costs their complaint for a refund of federal income tax in the amount of $39,076.12, paid by them as a deficiency for the calendar year 1948, plus interest in the amount of $7,731.07, paid by them upon said deficiency, a total of $46,807.19, plus interest on said total as allowed by law.

Defendant, United States of America, having filed an answer, the facts were stipulated.

The court entered findings of fact and conclusions of law.

During the years 1944-1946, plaintiffs acquired 3,533 shares of 7% cumulative prior preference stock of Portland Electric Power Company (hereinafter referred to as "Portland"), a public utility holding company, at a cost of $140,031. During 1948 plaintiffs sold all of such stock (also herein referred to as prior preference stock) for an aggregate net price of $608,063.16. They reported the difference between said cost and said sale price, *i.e.*, $468,032.16, as long-term capital gain on their joint income tax return for 1948, and paid income tax on said gain.

The internal revenue service contended that $103,091.25 of the $468,032.16 reported by plaintiffs as long-term capital gain was constructively received by plaintiffs as a dividend and should have been reported as dividend income, and adjusted plaintiffs' taxable income for 1948 accordingly. Based on said adjustment plaintiffs paid said deficiency.

For some years prior to 1948 Portland was involved in a bankruptcy reorganization proceeding in the United States District Court for the District of Oregon and in a proceeding before the Securities and Exchange Commission relating to its liquidation as a public utility holding company. The reorganization was consummated pursuant to a formal Plan of Reorganization[1] confirmed by the District Court on October 11, 1947.

Under this Plan, Portland General Electric Company (hereinafter referred to as "PGE"), a wholly owned operating subsidiary of Portland, was to reclassify and increase its authorized common stock and to issue to Portland 998,966.58 shares of such new common stock in exchange for the previously outstanding common held by Portland. PGE was also to transfer to Portland a

1. Herein sometimes referred to as the Plan.

dividend of $1,600,000 in cash and $93,000 principal amount in Portland's own bonds. Portland was then to distribute cash and common stock of PGE to the holders of Portland's bonds and prior preference and first preferred stock in exchange for the Portland securities held by them.[2]

Under the Plan, the holder of each share of prior preference stock was to receive, in exchange therefor, $6\frac{1}{4}$ shares of common stock of PGE in full satisfaction of his claims thereon, including all accrued and unpaid dividends. Holders of Portland first preferred stock were to receive $\frac{2}{3}$ of a share of common stock of PGE for each share of their stock. Holders of Portland second preferred stock and common stock were to receive nothing under the Plan and these stocks were to be cancelled. The holders of prior preference stock were to be given ten years after entry of final decree in the reorganization within which to exchange such prior preference stock for common stock of PGE.

The distributions of PGE stock under the Plan were based upon the value of the properties of Portland, including the PGE stock, as of October 31, 1945. Subsequent to October 31, 1945, PGE had earnings which were of a value equivalent to the interest accruing to the holders of Portland bonds after October 31, 1945, and to the accrual of dividends on the prior preference stock after that date.

Out of the retained earnings of PGE earned after October 31, 1945, its directors on July 7, 1947, declared a spe-

2. The holders of prior preference stock, by its terms, were entitled to cumulative dividends at the rate of 7% per annum from January 1, 1933, and upon liquidation or dissolution of Portland were entitled to priority over the holders of other classes of stock in the distribution of assets to the extent of $100 per share, together with unpaid accumulated dividends. The first preferred stock of Portland was junior to the prior preference stock, but ranked

cial dividend of $3 per share to be paid to the holders of the new common stock of PGE when and if such stock should be issued pursuant to the Plan. In confirming the Plan on October 11, 1947, the court found that the values of the properties of Portland as of October 31, 1945, plus the retained earnings of PGE plus the said $3 special dividend, were a fair and equitable basis for the distribution of the assets of Portland to its security holders. It found that the distributions so computed would satisfy the claims of the bondholders, would enable the holders of the prior preference stock to receive the par value of such stock plus all accumulated dividends, and would leave some equity for the holders of the first preferred stock.

On November 12, 1947 and on December 22, 1947, the directors of PGE declared additional special dividends of 45¢ each per share to be paid to the holders of the new common stock of PGE when and if such stock should be issued pursuant to the Plan. In addition, on March 10, 1948 and June 8, 1948, the directors of PGE declared additional dividends of 45¢ each per share to be paid to the holders of the new common stock of PGE, such dividends to be paid to stockholders of record on March 31, 1948 and June 30, 1948, respectively. As to Portland securities which had not been exchanged on those dates, such dividends were to be paid only if and when such securities were exchanged for PGE stock and then only pursuant to an assignment of such dividends by the Independent Trustees of Portland to the holders of such securities at the time of the exchange. The Independent Trustees of Portland were trustees for Portland in the bankruptcy reorganization.

Upon the consummation of the Plan Portland was to be completely dissolved and liquidated and was not to have any officers or directors.

By an order of the district court in Oregon, entered

named exchange agent in order to execute the Plan in accordance with its provisions. The newly issued common stock of PGE was delivered to the exchange agent on or before February 2, 1948. The special dividends, previously referred to, were paid to the exchange agent and held for future distribution to the holders of Portland securities upon the exchanges being made.

From and after the effective date of the Plan (February 2, 1948) the holders of prior preference stock were entitled to exchange such stock for common stock of PGE, and to receive the dividends thereon. The final decree of the court fixed June 4, 1951, as the last date on which such exchange must be made under the Plan. If the exchange were not made by that date, the stock would become valueless in the hands of the holders.

Plaintiffs never exchanged their stock for common stock of PGE and never received the dividends declared on the PGE stock. Instead, plaintiffs sold their stock at various times during 1948. During all of 1948 there was active trading in that stock, and quotations thereon were listed by the National Quotation Bureau, Incorporated, which ranged from a low of 169 to a high of 181 on the dates of sales by plaintiffs.

I. Plaintiffs contend that they were never stockholders of PGE and never received the dividends in question. While plaintiffs chose not to exchange their prior preference stock for common stock of PGE and so never directly received the dividends declared on the latter stock, they did sell their Portland stock in 1948 and it is undisputed that these sales carried the right to collect the dividends which defendant seeks to tax as income to plaintiffs. The purchasers of this stock acquired from plaintiffs the right to collect those dividends. Plaintiffs concede that they

sold a "totality of rights, *i.e.*, the tree as well as the fruit". It is incredible that the total sale price did not include the value of the accrued dividends, and they take no such contention. It is obvious that the value of the dividend rights sold was a part of the consideration which plaintiffs received when they sold their stock without exercising their right to collect the dividends themselves. Under these circumstances, for tax purposes the amounts of these dividends were constructively received by plaintiffs and they are accountable therefor as ordinary income.

Defendant relies upon the following sections of Treasury Regulation 111, under the Internal Revenue Code of 1939:

> Sec. 29.42-2. **Income not reduced to possession.** Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. • • •
>
> Sec. 29.42-3. **Examples of constructive receipt.** • • • Dividends on corporate stock are subject to tax when unqualifiedly made subject to the demand of the shareholder. • • •

Undoubtedly the underlying reason for these provisions is to be found, *inter alia*, in *Corliss* v. *Bowers*, 281 U.S. 376, 378, where the court said:

> • • • The income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income, whether he sees fit to enjoy it or not. • • •

It is obvious that what plaintiffs sold was the right to obtain from the exchange agent the PGE shares, with accumulated dividends, for which the shares of Portland were exchangeable. Thus, plaintiffs realized ordinary in-

come to the extent of the amount of the dividends involved, which were in effect collected as a part of the sale price of their Portland stock. *Hilbert v. Commissioner*, 227 F.2d 399, 401. In such circumstances, plaintiffs, as an incident to the sale of their Portland stock, disposed of their right to the income embodied in the dividends which were payable thereon. The dominant purpose of the revenue laws is the taxation of income to those who enjoy the benefit of it when paid. See *Helvering v. Horst*, 311 U.S. 112, 116, and *Fisher v. Commissioner*, 209 F.2d 513, 515.

In *United States v. Swan*, 223 F.2d 103, 108, the court said:

> "The general rule is that a right to receive ordinary income, produced by a capital asset, is not transmuted into a capital asset by the sale or assignment of the capital asset together with the right to receive the ordinary income. * * *"

2. Plaintiffs make the further contention that, even if they had actually received the dividends declared by PGE, such payments would have given rise to *capital gain* as cash received in liquidation of Portland. They rely on § 115 (c) of the Internal Revenue Code of 1939[3] which provided:

> Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock. * * *

As to the $5 dividend declared on July 7, 1947, they point out that the Oregon district court found:

> "* * * Said special dividend, together with said retained earnings of Portland General Electric Company allocable to the stock to be distributed to the

3. 53 Stat. 870 (1939), § 115 (c).

beneficiaries of debtor, is of a value equivalent to the interest accruing upon the claims of the holders of the bonds of debtor subsequent to October 31, 1945, and that the portion represented by the stock to be allocated under the plan as amended to the prior preference stockholders is of a value equivalent to the accrual of dividends upon such prior preference stock subsequent to October 31, 1945.

"That the value of the properties of debtor as of October 31, 1945, together with the values of the special dividend hereinbefore mentioned and the retained earnings of Portland General Electric Company, are a fair and equitable basis for the distribution of the cash and other assets of debtor as provided in said amended plan to the security holders of debtor according to their respective claims, interests and priorities."

It is plaintiffs' theory that so of $3 dividend must be regarded as a distribution in the complete liquidation of Portland and, if constructively received by plaintiffs, it must be treated as payment in exchange for their Portland prior preference stock; and that, if plaintiffs are treated as having sold the right to such $3 dividend along with their Portland stock, then the proceeds of sale must be accorded similar treatment; in either case any gain must be taxed as capital gain.[4] They rely heavily on *Kirby v. Commissioner*, 35 B.T.A. 578, reversed on other grounds at 102 F.2d 115. However, we have examined the *Kirby* opinion and find that in that case ordinary dividends on stock owned by a corporation were paid to the liquidating trustees of that corporation and then distributed by them to its stockholders. Those dividends were taxable to the corporation. Of course, when they were thereafter distributed to its stockholders as a part of a complete

[4] Plaintiffs also contend that the dividends declared as November 12, 1947, December 22, 1947, March 10, 1948 and June 8, 1948

liquidation of the corporation, the taxholders were taxable on a capital gains basis only. The case at bar presents a different situation. Here the dividends on the PGE stock were never the property of Portland and therefore could not have been distributed as a liquidating dividend of Portland. These dividends were paid to the exchange agent to hold for the stockholders who were entitled to them, which included the plaintiffs or their assignees.

Paragraph VI (C) of the Plan provides:

> Holders of Prior Preference Stock upon consummation of the Plan are to receive in full satisfaction of their claims thereon, including all accrued and unpaid dividends, for each share of such stock, 6½ shares of PGE Common Stock and the rights of the holders of such stock shall be modified and altered accordingly.

It included all dividends plaintiffs were entitled to as of October 31, 1945. See *Petition of Portland Electric Power Co.*, 162 F.2d 618 (9 Cir.) where the Plan was approved.

We hold that the $3 and subsequent dividends on PGE stock were not liquidating distributions but were distributions of earned profits of PGE, a going concern, and are to be treated as ordinary dividends.

For the reasons herein stated, the order of the district court from which plaintiffs appeal is affirmed.

AFFIRMED.

MADDOX, *C.J.*, dissenting. My conviction that this case should be reversed is such that I feel compelled to dissent. Judge Schnackenberg has made an adequate statement of the facts and I disagree only with the rule which he applies thereto.

The government relies upon the theory of constructive receipt in holding plaintiffs accountable for the dividends as ordinary income. It appears to waver, however, as to the time of such receipt. It states in its brief, "* * * the dividend income was clearly realized by taxpayers in 1948, and it was so realized not later than the dates when collected as part of the proceeds of the sales of the Portland stock."

In my opinion, the rights and liabilities of Portland shareholders were definitely fixed on February 2, 1948, when the Plan of Reorganization was confirmed. On that date plaintiffs and other shareholders, as well as their assignees, acquired a right, an option, which was exercisable at any time within ten years. The Plan provided a formula by which Portland shareholders, upon compliance with the terms and conditions thereof, might at their option acquire PGE shares. If Portland shareholders desired to exercise the option thus afforded them, it was required that they exchange their shares for those of PGE upon which dividends had been declared. It was further required that they become record owners of PGE shares and, even then, they were entitled to dividends only "pursuant to an assignment of dividends from the independent trustees of Portland Electric Power Company to such shareholders."

How it can be thought or held under such circumstances that plaintiffs as shareholders of Portland had an unfettered and unqualified right to the receipt of dividends declared on PGE shares and made payable only to the record holders thereof is not discernible to me. Plaintiffs never owned any PGE shares and, in the exercise of a right provided by the Plan, were not required to become such owners.

The government emphasizes the point that plaintiffs' shares would have become valueless [illegible]

change within ten years, thus intimating that sooner
later they would have been under an economic compuls
to make such exchange. The theory is not tenable. T
wise, it was no concern of the government if plaint
exercising the rights conferred by the Plan, improvident
hold their shares until they became of no value. At a
rate, I am aware of no law which requires a person
produce income. The farmer has a right to permit
fields to lie fallow, and the merchant or professional m
can close the doors to his business or office, even for t
express purpose of avoiding income. Plaintiffs, under
circumstances, had the same right relative to their Po
land shares.

The constructive receipt theory must be predicated up
the fictional premise that the Polk shares were constru
tively received by plaintiffs and, having been thus
ceived, the dividends declared thereon were also constru
tively received. Thus, one constructive receipt is impos
upon another. I know of no case which supports this tw
fold imposition of the theory.

The theory relied upon is perhaps best illustrated
Helvering v. *Horst*, 311 U.S. 112, which has been oft
cited and followed. There, a father, owner of negotiab
bonds, detached therefrom interest coupons before the
due date and delivered them to his son who collected the
at maturity but in the same year. It was held that t
father was accountable for the interest represented by t
coupons on the theory of constructive receipt. Obviously
the father as owner of the bonds had the unqualified an
unfettered right to the receipt of such interest. Suppose
however, that the interest of the father in that case ha
been limited to an option, exercisable at will, to purchas
the bonds with the coupons attached. Could it be seriously
contended that he would be required to account for a
ordinary income the interest earned on such bonds? Con

reason that plaintiffs as shareholders of Portland did not have an unqualified and unfettered right to the receipt of dividends which had been declared on PGE shares.

This constructive receipt theory, if applicable, could produce the incongruous result of numerous taxpayers being held accountable for the same dividends. The Portland shares might have been sold many times before they reached a purchaser who was willing to exchange such shares for those of PGE and thereby receive the dividend. It happens in the instant case that the purchaser elected to make the exchange and receive the dividends. The stipulation entered in the case includes the claim for refund filed by plaintiffs. That claim discloses without denial that such exchange was made by the purchaser who reported as ordinary income the amount received as dividends and paid the tax thereon. Ti is, both plaintiffs as sellers of Portland shares and the purchaser of such shares have been taxed upon the same dividend income. It is interesting, although perhaps immaterial, to contemplate how the government would defend its right to collect from different parties a tax upon the same income. This situation, however, furnishes strong support for my position, that is, that only an owner of Portland shares who elected to exercise his option of making an exchange for PGE shares was accountable for dividend income.

I would reverse and remand the case, with directions that a judgment be entered in favor of plaintiffs.

A true Copy:
Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

JUDGMENT ORDER

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago 10, Illinois

Friday, February 5, 1960

Before

Hon. J. Earl Major, Circuit Judge
Hon. Elmer J. Schnackenberg, Circuit Judge
Hon. Latham Castle, Circuit Judge

No. 12762

Avery Brundage and Elizabeth D. Brundage, *Plaintiffs-Appellants*, v. United States of America, *Defendant-Appellee*.	Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in cause appealed from be, and the same is hereby, AFFIRMED, in accordance with the opinion of this Court filed this day.

ORDER DENYING PETITION FOR REHEARING

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago 10, Illinois

Wednesday, March 30, 1960

Before

Hon. ELMER J. SCHNACKENBERG, Circuit Judge
Hon. LATHAM CASTLE, Circuit Judge
Hon. J. EARL MAJOR, Circuit Judge

No. 12762

AVERY BRUNDAGE, et al., *Plaintiffs-Appellants,* v. UNITED STATES OF AMERICA, *Defendant-Appellee.*	Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

IT IS ORDERED by the Court that the appellants' petition for a rehearing of this cause be, and the same is hereby, DENIED.

ORDER DENYING PETITION FOR REHEARING IN BANC

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago 10, Illinois

Wednesday, March 30, 1960

Before

Hon. JOHN S. HASTINGS, Chief Judge
Hon. F. RYAN DUFFY, Circuit Judge
Hon. ELMER J. SCHNACKENBERG, Circuit Judge
Hon. WM. G. KNOCH, Circuit Judge
Hon. LATHAM CASTLE, Circuit Judge

No. 12762

...VERY BRUNDAGE, et al.,
Plaintiffs-Appellants,

v.

...NITED STATES OF AMERICA,
Defendant-Appellee.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

IT IS ORDERED by the Court that the appellants' petition for a rehearing *in banc* of this cause be, and the same is hereby, DENIED.

...UFFY, C. J. dissents).